

STATE OF NORTH DAKOTA

MARKET CONDUCT EXAMINATION REPORT

FARMERS UNION MUTUAL
INSURANCE COMPANY

As of December 31, 2003

By Representatives of the
North Dakota Insurance Department 14 MC-03-133
9/2/04
Examination report

STATE OF NORTH DAKOTA
DEPARTMENT OF INSURANCE

I, the undersigned, Commissioner of Insurance of the State of North Dakota, do hereby certify that I have compared the annexed copy of the Market Conduct Examination Report of the

**Farmers Union Mutual Insurance Company
Jamestown, North Dakota**

as of December 31, 2003, with the original on file in this Department and that the same is a correct transcript therefrom and of the whole of said original.



IN WITNESS WHEREOF, I have hereunto

set my hand and affixed my official

seal at my office in the City of Bismarck,

this 24th day of August, 2004.



Jim Poolman
Commissioner of Insurance

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Bismarck, North Dakota

Honorable Jim Poolman
Commissioner of Insurance
State of North Dakota
600 East Boulevard Avenue, 5th Floor
Bismarck, ND 58505-0320

Dear Commissioner Poolman:

Pursuant to your instructions and in accordance with N.D. Cent. Code § 26.1-03-19.2 and the rules, regulations, and procedures established by the National Association of Insurance Commissioners (NAIC), a comprehensive market conduct examination has been made of the North Dakota business of:

FARMERS UNION MUTUAL INSURANCE COMPANY
P.O. Box 2020
Jamestown, ND 58402-2020
NAIC # 32670

A report thereon is submitted as follows:

INTRODUCTION

The North Dakota Insurance Department Market Conduct Examiner conducted the examination at the Company's home office using the NAIC Market Conduct Examination Handbook.

SCOPE OF EXAMINATION

This examination report reflects the North Dakota insurance activities of Farmers Union Mutual Insurance Company ("FUMIC" or "the Company"). The examination followed the NAIC Market Conduct Handbook procedures. Therefore, the examination report is, in general, a report by exception. Additional practices, procedures, or files subject to review are omitted, as to reference, if no improprieties were indicated.

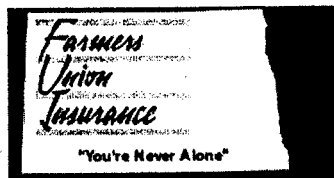
The on-site portion of the examination commenced in January 2004 and concluded in July 2004. The examination covered the period of January 1, 2002, to December 31, 2003.

Virginia Carter, Market Conduct Examiner and Special Assistant Attorney General for the North Dakota Insurance Department, conducted the initial phase of the examination. Charles E. Johnson, General Counsel, Kathy Wolf, Property/Casualty Complaint Investigator, and Craig Burns, Legal Counsel, completed the exam. The Examiners conducted the exam of the Company under the rules and regulations prescribed by the NAIC to evaluate the Company's compliance with statutes and regulations relating to market conduct practices and the Company's treatment of policyholders and claimants.

The major areas reviewed were:

1. Company operations/management.
2. Complaint handling.
3. Marketing and sales.
4. Producer licensing.
5. Policyholder service.
6. Underwriting.
7. Claims practices.

COMPANY PROFILE



FUMIC is a property and casualty insurance company. A.M. Best, an independent rating agency of insurance companies rated FUMIC A- (Excellent).

FUMIC originated as a mutual insurance company under the laws of the State of North Dakota when the Company incorporated on March 20, 1944. The Company's primary lines of business consist of farmowners, homeowners, and commercial multiple peril.

Membership

Membership consists of policyholders of the Company who are members in good standing in the Farmers Educational and Cooperative Union of America, North Dakota Division.

The Board of Directors sets the date and place of the annual meeting of the members at the time and place of the annual convention of the Farmers Educational and Cooperative Union of America, North Dakota Division. Notice of the annual meeting of the membership shall be by publication in the North Dakota Union Farmer or by written notice to each member at his last known address.

Each member of the Company is, for the purpose of representation, assigned to a local and/or county governing unit of the Farmers Educational and Cooperative Union of America, North Dakota Division.

Board of Directors

The Board of Directors consists of nine members elected by the policyholders for a one-year term. One director is chosen from each of seven districts in the state and two directors are elected at large.

The Board of Directors holds the annual meeting immediately following the annual convention of the Farmers Educational and Cooperative Union of America, North Dakota Division. The directors shall hold regular quarterly meetings in November, February, May, August, or at such other time and place as the Board may fix by resolution. For the period under examination, the Board of Directors adequately documented the discussions in the minutes.

Directors are as follows:

Name

Robert L. Carlson
Richard Schlosser
Terry Borstad
Larry Novak
Bob Finken
Dennis Stromme
Elwood "Woody" Barth
Marcy Svenningsen
Terry Ulrich

Officers

The Board of Directors elects the officers who serve until the next annual meeting of the Board. Elected officers are as follows:

Officer

Robert L. Carlson
Richard Schlosser
Odean Olson

Title

President
Vice President
Secretary and Treasurer

Committees

The Board of Directors designated committees to assist the directors in various aspects of Company operations. Three committees and their respective members were as follows:

Executive Committee

Robert L. Carlson
Terry Ulrich
Larry Novak
Richard Schlosser

Claims Committee

Robert L. Carlson
Odean Olson
Randy Lebahn

Rate and Policy Committee

Odean Olson
Mike McCormick
Gary Geiszler
Randy Lebahn
One District Manager
Two agents (at large)

Conflict of Interest

The Company procedure for disclosure of any conflict of interest requires that each director, officer, trustee, or responsible employee of the Company annually sign a conflict of interest statement. The Board of Directors reviews the signed statement. The Examiners reviewed the conflict of interest statements filed by the officers and directors and found no conflicts for the examination years 2002 through 2003.

Territory

According to FUMIC's 2002 Schedule T form, FUMIC is licensed in North Dakota and South Dakota. The Company currently writes business only in the State of North Dakota.

AREAS OF REVIEW

Company Operations/Management

The Examiners conducted a review of FUMIC's operation and management systems. The Company Operations and Management area provides an overview of how a company operates.

The review included, but was not limited to a review of minutes of the Board of Director meetings, Company policy manuals, underwriting guidelines, claims adjusting manuals, Company complaint logs, FUMIC's antifraud plan and training, disaster recovery plan, subrogation procedures, records retention guidelines, and privacy procedures.

In the area of privacy, FUMIC provided copies of its privacy policy and its privacy notice along with evidence that the privacy notice has been provided initially as required by the federal Gramm-Leach-Bliley requirements and annually thereafter to FUMIC customers as required by N.D. Admin. Code Article 45-14. The Company also provided information showing that the Company has implemented procedures to protect consumer privacy from improper disclosure to nonaffiliated third parties. The Company does not share information with nonaffiliated third parties so it is not necessary for the Company to maintain a list of consumers that have elected to opt out of the sharing of protected information with nonaffiliated third parties. The Company's initial privacy notice included a form for opting out, and certain policyholders elected to opt out, but with the Company's present policy of not sharing protected information, it is no longer necessary to maintain the "opt out" list.

Company records for the most part were adequate, accessible, consistent, and orderly. The Company's Executive Committee, Claims Committee, and Rate and Policy Committee meet on an "as needed" basis. The Executive Committee and Claims Committee did not meet during the period reviewed by the Examiners. The Rate and Policy Committee met once, but no formal minutes were kept of the meeting. A good business practice for the Company would be to keep official minutes of any committee meeting as an official record of the activity of the committee.

Recommendation: *It is recommended that the Company keep formal minutes of the meetings of its Executive Committee, Claims Committee, and Rate and Policy Committee as those meetings occur.*

The Examiners noted that the Company does not have a Board of Directors' Complaint Oversight Committee. The Board should maintain some oversight over the nature of the complaints and the Company's response to those complaints. A better practice would be for the Company to organize a Board of Director's Complaint Oversight Committee to meet and review complaints and the Company's response to those complaints.

Recommendation: *It is recommended that the Company organize a Board of Directors' Complaint Oversight Committee, that the committee meet on a regular basis, and that the committee keep formal minutes of the meeting to document the activity of the committee.*

The Examiners would like to note that the Company cooperated on a timely basis with the Examiners performing the examination.

No other exceptions were noted for this area.

Complaint Handling

The Examiners reviewed the Company's complaint handling practices to determine Company compliance with state laws and regulations and to identify any complaint patterns or trends. An examination was made of the Company's complaint register and complaint files, the Department's complaint database, and the NAIC Complaints Database System (CDS).

The Company files showed that the Company responded to complaints in a timely manner as required by N.D. Cent. Code § 26.1-04-03(10) for Company complaint files opened between January 1, 2002, and December 31, 2003. The Company files showed that the complaints were resolved within a reasonable period of time, with the majority of the complaints resolved within 15 days and all but a few complaints resolved within 60 days. The Company tracks oral and written consumer complaints made to the Company and written complaints made through the North Dakota Insurance Department. Complaints are tracked by each of the Company's Claims, Underwriting, Marketing, and Processing Departments. Each department keeps separate complaint logs on a quarterly basis. The log sheets contained detailed information regarding the complaint and the resolution of the complaint, which was helpful to the Examiners.

The Marketing Department complaint logs included at least two complaints that failed to list a "date closed" date even though the report was completed some time after the complaint was filed. Also, for at least two Claims Department complaints, the Insurance Department claim number was not listed, even though the report showed that the complaint was an Insurance Department complaint. It would have been more helpful to the Examiners had the Insurance

Department complaint number been included in the complaint log for each Insurance Department complaint.

Recommendation: *It is recommended that the complaint logs include "date closed" information for all complaints and include Insurance Department claim numbers for Insurance Department complaints.*

No other exceptions were noted for this area.

Marketing and Sales

The Marketing and Sales examination reviewed advertising materials and other representations made by the Company about its products. The Examiners requested and reviewed all advertising materials in use during the examination period including newspaper and magazine ads, scripts for radio and TV ads, and informational materials prepared for agents' training and use. The review examined whether or not the materials are truthful, clear, and contain adequate disclosure—the minimum standards for advertising set forth in the North Dakota Century Code and the North Dakota Administrative Code (N.D. Admin. Code Chapter 45-04-10 - Advertising Rules).

As these advertising rules also pertain to Internet advertising, the Examiners performed an Internet search for websites referring to FUMIC and reviewed these sites.

The Examiners noted no exceptions for this area.

Producer Licensing and Agent Oversight

The Examiners compared agent licensing information obtained from the North Dakota Insurance Department with the Company's information pertaining to licenses and appointments of individuals soliciting business on behalf of the Company.

The Examiners reviewed approximately 40 files in which 6 newly appointed agents placed insurance to determine whether or not the Company agents were properly appointed before placing insurance. The files showed that all agents were properly appointed prior to taking applications for insurance. It was noted that the newly appointed agents assumed existing accounts with existing agencies and that existing agents handled the accounts until the new agents were properly appointed.

The Examiners also noted that the Company implemented policies relating to agent binding authority as recommended in a prior Department exam and appears to be enforcing these policies. The Examiners noted several occasions in which agents were reprimanded for attempting to bind commercial insurance when the underwriting guidelines did not allow an agent to bind commercial insurance. In these instances, the Company immediately notified the policyholder and the agent that insurance was not in place and that insurance would not be placed until the Company completed its underwriting investigation.

The only significant issue involving agent activity involved a dispute between the Company and the agent regarding a request for an extension of time for a policyholder to repair hail damage to his home. The agent maintained that he had faxed in a request for an extension prior to the

expiration of the repair period, yet had no copy of the fax or other evidence of the document being sent. The Company never received the fax. Based on the agent's statement, the Company eventually allowed the claim and paid for the repairs. To avoid similar disputes in the future, the Company should emphasize during agent training that the agent must maintain a copy or other record of all critical communications with the Company as evidence of that communication.

Recommendation: *It is recommended that the Company should emphasize during agent training that the agent must maintain a copy or other record of all critical communications with the Company as evidence of that communication.*

The Examiners noted no other exceptions for this area.

Policyholder Service

The policyholder service portion of the examination tested the Company's compliance with statutes and rules regarding premium and billing notices, correspondence, policy transactions, and other related issues as suggested in the NAIC Market Conduct Examiners Handbook. The Examiners reviewed files for policyholder service issues while reviewing the underwriting, claims, and agent appointment files.

In general, the Examiners found that the Company is responsive to its policyholders and corresponds with its policyholders within a reasonable time, issues cancellation and nonrenewal notices sufficiently in advance of the cancellation or nonrenewal date, makes claims payments and cancellation refunds in a timely manner, and responds to and resolves complaints within a reasonable time.

The Examiners found that FUMIC's notices of intent to nonrenew were mailed at least 30 days prior to the nonrenewal date, refunds were processed and mailed within a two-week period, and notices regarding the Company's decision not to provide the coverage requested in an application were sent along with the declaration sheet and within the 14-day period allowed for the processing of the application.

The examination found that the Company nonrenewals, whether for underwriting reasons, excessive claims experience or other reasons, were justified and were in accord with the Company underwriting guidelines.

The Examiners noted that very few nonrenewals resulted from excessive claims, which seemed unusual. The Company representatives noted, however, that the claims during the examination period 2002 and 2003 were relatively few so that there were few nonrenewals based on claims. The Examiners noted that on a few occasions policyholders ended their relationship with the Company because of a dissatisfaction with an agent or because of a dissatisfaction with a claims payment. The number of occasions was relatively few in light of the number of Company policyholders and the number of claims.

The Examiners noted one issue relative to cancellations. With respect to the cancellation on Policy No. 16956, it appears that the Company issued its notice of cancellation on January 29, 2004, retroactive to December 12, 2003. Company cancellations cannot be made retroactive without policyholder approval otherwise the policyholder will be exposed to potential claims

during the gap in coverage. Cancellations must be effective on the date the policy is canceled, unless the policyholder agrees otherwise.

Recommendation: *It is recommended that cancellations be effective prospectively, or at the date requested by the policyholder.*

In reviewing cancellation files, it was noted that Company records showed that the overwhelming number of cancellations were coded as reason "G", which was identified as "Underwriting Requirements/Loss History". In some instances, however, a file was canceled for reasons other than underwriting, such as foreclosure, but was improperly coded as an underwriting cancellation.

Recommendation: *It is recommended that the Company properly code the reasons for policy cancellations.*

Underwriting and Rating

The underwriting and rating portion of the examination tested the Company's treatment of the public and whether that treatment is in compliance with statutes, rules, and regulations pertaining to underwriting and rating issues. The review provided insight into the Company's rating, underwriting, and termination practices.

The Company demonstrated compliance with applicable statutes and rules in this area. For example, upon review of the underwriting procedure and files, the company's underwriting guidelines were followed and no instances of unfair discrimination were noted.

The Examiners reviewed several files for each of the top six producing agencies to determine whether or not the Company was enforcing its underwriting guidelines for all agencies, large and small. The Examiners found that the large agencies were required to adhere to the guidelines, without exception, and were not given preferential treatment with respect to placing or renewing insurance.

The Examiners reviewed approximately 75 files in which an application for insurance was denied because of underwriting reasons such as age or condition of buildings, vacancy, prior claims history, or inadequate insurance score, among others. The Examiners found that the denials were in accordance with the Company's underwriting guidelines, were for good cause, and that the guidelines were properly and uniformly applied.

With respect to underwriting practices, agents are allowed to bind general homeowner policies subject to certain restrictions, but complicated commercial underwriting and rating issues were submitted to the lead underwriter. The lead underwriter's underwriting decisions were made on a timely basis and customers were notified promptly of the decision. At times the Company was unable to offer the level of coverage requested by the applicant. In those cases, as noted earlier, the applicant was notified promptly that the coverage placed did not conform to the coverage requested.

In an effort to control claims experience, the Company records show that the Company is canceling policies in which a property becomes vacant or lacks maintenance. Policyholders with excessive claims experience are either nonrenewed or are assigned a higher deductible in accordance with Company guidelines.

No exceptions were noted in this area.

Claims

The Examiners reviewed the Company's claims handling practices in order to provide an overview of the Company's treatment of claimants and whether that treatment complies with applicable statutes, rules, and regulations. The review included approximately 50 claims files in which claims were paid and approximately 50 files in which payment was denied either because of no coverage or because the claim was less than the deductible.

In general, the Company consistently makes initial contact with claimants, conducts investigations, responds to claim correspondence, and settles claims in a timely manner. The Company also maintains an adequate claim procedure manual and generally follows established procedures. The Examiners found that FUMIC's claim files were well documented with investigations, follow-up and settlement of claims performed in a reasonably timely manner.

The Examiners also noted that claims that were paid were paid in accord with policy provisions, claims that were denied were denied for proper reasons, and claims that fell below the deductible threshold were reasonably evaluated.

The Examiners noted certain claim files that appeared to be unusually adverse to the Company (i.e., excessive loss history). The Company took appropriate action to curtail its future losses on these files by raising deductibles or limiting coverage, as noted above.

The Company's complaint logs showed that the Company received occasional complaints regarding the handling of claims, most often because the policyholder expected a larger payment from the Company. At times policyholders ended their relationship with the Company because of the policyholder's dissatisfaction with the claims payment. The Examiners could find no evidence in the files that claims were handled inappropriately.

The Department's complaint records and the Company complaint logs show that in a few claims files an adjustment was made to the claim payment as a result of a policyholder's complaint, whether the complaint came through the Insurance Department or came directly to the Company. The number of adjustments was relatively small compared to the number of claims settled during the 2002-2003 examination period, namely 2,312 claims in 2002 and 1,591 claims in 2003, but does show that the Company is willing to review its claims decisions and modify those decisions from time to time.

The Examiners noted several files in which a claim had been made and where the Company had requested additional information from the policyholder. After receiving no response to the policyholder, the Company sent either a 14-day or a 30-day notice letter to the policyholder notifying the policyholder that the file would be closed if the policyholder did not respond within that time. Most often the policyholder did not respond so that the Company properly closed the file after the time period expired.

It should be noted that a few claims files did not include a copy of the letter that was sent. A better practice is to include a copy of the notice letter in all files in which the letter was sent.

Recommendation: *It is recommended that a copy of all notice letters be included in the claims file.*

No other exceptions were noted in this area.

Other

The Examiners reviewed approximately 60 files of the Company's 6 highest producing agencies as a followup to the Insurance Department's previous examination. The Examiners found that the Company has implemented new policies as recommended in the previous exam that limited the agent's authority to bind coverage. The Examiners found, as noted above, that agents that attempted to bind commercial policies were advised that the agent had no authority to bind commercial coverage. The Company did not bind coverage until Company underwriting was completed. The Examiners found that the Company is adhering to its improved underwriting guidelines and has taken better control of its policy activity as suggested in the Department's past examination report.

The Examiners also requested information regarding the relationship between the Company and the Farmers Educational and Cooperative Union of America, North Dakota Division (Farmers Union) specifically with respect to the existence of any agreement under which the Company was obligated to pay moneys to Farmers Union. The information showed that an insured must be a member of the Farmers Union to be a Company policyholder. The Company collects dues and remits the dues to Farmers Union. Also, Article VI of its Bylaws provides: The Company shall set aside a sum equal to five percent of the annual net income of the Company before taxes as an educational fund to be used in teaching cooperation, all of which shall be paid to the Farmers Educational and Cooperative Union of America, North Dakota Division. There is no other arrangement under which the Company is obligated to make any payment to Farmers Union for services rendered by Farmers Union to the Company or otherwise.

CONCLUSION

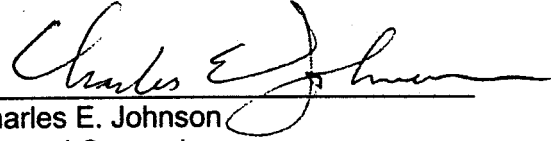
The Examiners conducted an examination of the market conduct affairs of Farmers Union Insurance Company for the period of January 1, 2002, to December 31, 2003. The Examiners conducted this examination in accordance with NAIC market conduct examination procedures and included analyses of Company operations in the areas of company operations/management, complaint handling, marketing and sales, producer licensing, policyholder service, underwriting and rating, and claims procedures.

The Examiners found no violations of North Dakota law or regulations.

The Examiners gratefully acknowledge the courteous cooperation extended by the officers and employees of the Company, especially the Company exam coordinator, Jason Wells, during the course of the examination.

DATED this 18th day of August, 2004.

Respectfully submitted,

A handwritten signature in cursive script, appearing to read "Charles E. Johnson", written over a horizontal line.

Charles E. Johnson
General Counsel
Special Assistant Attorney General
North Dakota Insurance Department

SUMMARY OF RECOMMENDATIONS

1. It is recommended that the Company keep formal minutes of the meetings of its Executive, Claims, and Rate and Policy Committees as those meetings occur.
2. It is recommended that the Company organize a Complaint Oversight Committee, that the committee meet on a regular basis, and that formal minutes of the meeting be kept to document the activity of the committee.
3. It is recommended that the complaint logs include "date closed" information for all complaints and include Insurance Department claim numbers for Insurance Department complaints.
4. It is recommended that the Company should emphasize during agent training that the agent must maintain a copy or other record of all critical communications with the Company as evidence of that communication.
5. It is recommended in the future that all cancellations be effective prospectively, or at the date requested by the policyholder.
6. It is recommended that the Company properly code the reasons for policy cancellations.
7. It is recommended that a copy of all notice letters be included in the claims file.